

Internal Revenue Service

District Director

Department of the Treasury

P.O. Box 2508
Cincinnati, OH 45201

Person to Contact:

Telephone Number

Refer Reply to:

EP/EO

Employer Identification Number:

Date: MAY 18 1995

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a trust or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the Office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

[REDACTED]

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue code provides in part that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely yours, [REDACTED]

[REDACTED]
District Director

Enclosures: 3

ENCLOSURE I

Facts

Information submitted with your application indicates that you were incorporated on [REDACTED] in the state of [REDACTED]. Your Articles of Incorporation state that you are organized exclusively for charitable, religious, scientific, literary, or educational purposes. The specific purpose for which you are organized is to "assist individuals and families that are in financial distress and hardships due to the existence or result of a union strike or shut out".

The organization will solicit donations from the general public but will be mainly supported by workers of companies whose employees have bargaining agreements with unions. The trustees will divide the state into "work areas" and act as sales representatives. They will ask the unions' permission to talk with workers about the organization's assistance program. The workers will then be encouraged to "donate" to the program through pay-roll deduction.

Assistance may be in the form of food and/or funds. Any member of a union company who is on strike or lock out for at least three weeks may receive "food vouchers" on a one-time basis, regardless of the recipient's financial status, union affiliation, or company affiliation. A "food voucher" is like a gift certificate which the recipient may redeem at face value at the store where the food voucher is purchased. The distribution of food vouchers is based on the availability of funds and the availability of funds is determined by the trustees.

Financial assistance include mortgage or rent assistance (maximum of \$[REDACTED] per three-month period not to exceed six months) and utilities assistance (maximum of \$[REDACTED] per three-month period not to exceed six months). The recipient must apply for the assistance and show that he has exhausted all of his strike benefits. The distribution of financial assistance (and the amounts of), like the distribution of food vouchers, is based on the availability of funds and the availability of funds is determined by the trustees.

The organization is controlled by four trustees:

- President [REDACTED]
- Secretary and wife of [REDACTED]
- Treasurer and brother of [REDACTED]
- Vice President and sister-in-law of [REDACTED]

████████████████████

According to the financial information submitted by you, your expenses will include salaries to the trustees, office expenses, and trustees' transportation. In the proposed budget, you stated that "excess revenue will be used for distribution to the intended beneficiaries of the organization". Upon inquiry, you stated that once the organization is "off and running", you anticipate that █% of all contributions received will be needed to cover salaries and expenses.

You subsequently put a cap to trustees' compensation at a rate not to exceed \$████ plus expenses within the state of █. As the organization progresses to other states, the trustees will receive an increase not to exceed █% per state. All increases will be reviewed by the trustees themselves periodically for necessary adjustments.

You stated that you do not wish to expand the board of trustees to include unrelated and uncompensated individuals because the four trustees have plans of giving up their current jobs to make the organization grow and to grow with it. The trustees feel that if they bring outsiders into the organization, give them the majority vote, and the authority to set policies, they "would be giving up all future security".

Law

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of those organizations that are organized and operated exclusively for charitable, educational, or religious purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

[REDACTED]

Section 1.501(c)(3)-1(c)(2) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)(1)-1(c) of the Regulations states that the words "private shareholder or individual" mean an individual having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of private interests.

Application of Law

Based on the information presented, we believe that you are operated for the benefit of private interests. Private interests in this case are two-fold: inurement to the four trustees and inurement to contributing members.

INUREMENT TO THE TRUSTEES

In Revenue Ruling 69-383, 1969-2 C.B. 113, a tax exempt hospital entered into a contract with a radiologist after arm's-length negotiations. The contract provided for the radiologist to be compensated by receiving a percentage of the gross receipts of the radiology department. The revenue ruling concluded that the agreement did not jeopardize the hospital's exempt status under section 501(c)(3) of the Code. In support of this conclusion, the following facts were noted: the agreement was negotiated on an arm's-length basis, the radiologist did not control the hospital, the amount received under the contract was reasonable in terms of the responsibilities and duties assumed, and the amount received under the contract was not excessive when compared to the amounts received by other radiologists in comparable circumstances.

In contrast, the situations in the following two court cases gave rise to inurement. In People of God Community v. Commissioner, U.S. Tax Court, 75 T.C. 127, the Court noted that there was no upper limit on the amount of compensation the minister could receive. Because there was no upper limit, the Court found that a portion of the church's income was simply being passed on to its minister.

[REDACTED]

In Wendy L. Parker Rehabilitation Foundation, Inc. v. C.I.R., T.C. Memo. 1986-348, the Tax Court upheld the Service's position that a foundation formed to aid coma victims, including a family member of the founders, was not entitled to recognition of exemption. Approximately 30% of the organization's net income was expected to be distributed to aid the family coma victim. The Court found that the family coma victim was a substantial beneficiary of the foundation's funds. It also noted that such distributions relieved the family from the economic burden of providing medical and rehabilitation care for their family member and, therefore, constituted inurement to the benefit of private individuals.

A common factual thread running through the court cases where inurement has been found is that the individual stands in a relationship with the organization which offers him the opportunity to make use of the organization's income or assets for personal gain. Your organization is controlled by related individuals who also determine their own compensation. A cap is artificially set but the same group of individuals determine what that cap will be.

INUREMENT TO THE CONTRIBUTING MEMBERS

In Revenue Ruling 67-367, 1967-2 C.B. 188, an organization established a plan under which it enters into so-called "scholarship" agreements with subscribers. Under the agreement, a subscriber agrees to deposit, either in periodic payments or in a lump sum, a specified sum with a designated bank. At the same time, the subscriber nominates a named child not over a specified age at the time the agreement is entered into who will receive a "scholarship" from the organization if he matriculates at a college. The Service ruled that the organization's "scholarship" plan for making payments to pre-selected, specifically named individuals does not qualify for exemption under section 501(c)(3) of the Code.

Revenue Ruling 69-175, 1969-1 C.B. 149 describes an organization formed by the parents of pupils attending a private school exempt under section 501(c)(3) of the Code. The organization provides bus transportation to and from the school for those children whose parents belong to the organization. The ruling states that when a group of individuals associate to provide a cooperative service for themselves, they are serving a private interest. By providing bus transportation for school children to school, the organization enables the participating parents to fulfill their individual responsibility of transporting their children to school.

Although you indicated that benefits are not limited to those contributing members and that they will be so informed, the contributing members expect to benefit from their contributions. Since the expectation is there, contributing members are providing a cooperative service for themselves. In addition, since "contributions" are made through pay-roll deduction, the beneficiaries are identifiable.

Conclusion

Based on the information submitted, your organization is a "vehicle" to job security for the trustees and, therefore, serves a private interest. The food and financial assistance is distributed to a finite and definite group of individuals cooperatively. You are in violation of the proscriptions in sections 1.501(c)(3)-1(c)(2) and 1.501(c)(3)-1(d)(1)(ii) of the Regulations. Accordingly, you do not qualify for exemption under section 501(c)(3) of the Code.